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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66552; File No. SR-C2-2011-043)

March 9, 2012

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, Relating to Changes to the Automated Improvement Mechanism

I. Introduction

On December 30, 2011, C2 Options Exchange, Incorporated (“Exchange” or “C2”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change relating to its Automated Improvement Mechanism (“AIM”). The proposed rule change was published for comment in the Federal Register on January 18, 2012.³ On March 2, 2012, the Exchange filed Amendment No. 1 to the proposed rule change.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1 thereto.

II. Description of the Proposal

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 66131 (January 11, 2012), 77 FR 2595 (January 18, 2012) (“Notice”).

⁴ In Amendment No. 1, the Exchange represented that it will provide to the Commission the same data that the Chicago Board of Options Exchange, Incorporated provides to the Commission in connection with that exchange’s AIM. See Securities Exchange Act Release No. 53222 (February 3, 2006), 71 FR 7089 (February 10, 2006). Amendment No. 1 is technical in nature, and therefore the Commission is not publishing Amendment No. 1 for public comment.

C2's AIM allows a Participant⁵ to cross an agency order it presents as agent ("Agency Order") against principal interest or a solicited order, provided that it first exposes the Agency Order to a one-second auction. If the Agency Order is 50 contracts or greater, the Participant ("Initiating Participant") must stop the Agency Order at the national best bid or offer ("NBBO") (or the order's limit price if better), and if it is less than 50 contracts, the Participant must stop the Agency Order at the NBBO improved by one minimum increment (or the order's limit price if better).⁶ When initiating an auction, an Initiating Participant submitting an Agency Order to the AIM either must indicate a single price at which it seeks to cross the Agency Order ("single-price submission") or must indicate that it will match as principal the price and size of all AIM responses ("auto-match").⁷ Once the Initiating Participant has submitted an Agency Order for processing, such submission may not be modified or cancelled.⁸ A Request for Responses ("RFR") will then be sent to any Participant that has elected to receive such requests, and the exposure period will last for one second.⁹ If the auction attracts responses (which may be submitted by Participants), the Agency Order will be allocated at the best price(s), subject to the allocation algorithm in effect for the option class, and public customer orders in the book will have priority.¹⁰ If the best price equals the initiating Participant's single-price submission, then the Initiating Participant will be allocated the greater of one contract or a specified percentage of

⁵ The term "Participant" is defined in C2 Rule 1.1.

⁶ See Rule 6.51(a)(2)-(3). See also Rule 6.51, Interpretations and Policies .03, noting that for at least a Pilot Period expiring on July 18, 2012, there will be no minimum size requirement for orders to be eligible for the auction.

⁷ See Rule 6.51(b)(1)(A).

⁸ See id.

⁹ See Rule 6.51(b)(1)(B)-(C).

¹⁰ See Rule 6.51(b)(3)(A).

the order, which percentage will be determined by the Exchange and may not be greater than 40% (or 50% in the case of a single-price submission where only one other market maker matches the price).¹¹

The Exchange proposes to amend Rule 6.51 to allow an Initiating Participant to enter an Agency Order for fewer than 50 contracts into the AIM at the NBBO. The proposal eliminates the distinction between orders for fewer than 50 contracts and orders for 50 contracts or greater and thereby will allow an Initiating Participant to submit to AIM an Agency Order of any size at the NBBO.

The Exchange also proposes to allow an Initiating Participant to elect to auto-match competing prices from other market participants up to a designated limit price. The Initiating Participant will not be able to cancel the auto-match instruction after an AIM Auction commences and will have no control over the prices at which it receives an allocation in the auction other than the outside boundary established by the designated limit price.

The Exchange notes that, during the existing pilot for certain components of AIM, there is no minimum size requirement for orders that are eligible for AIM. In connection with the pilot program, the Exchange represents that it will continue to submit to the Commission reports providing AIM Auction and order execution data, including monthly data regarding executions through AIM of agency orders for 50 contracts or greater or for fewer than 50 contracts, as supporting evidence that, among other things, there is meaningful competition for all size orders.¹²

¹¹ See Rule 6.51(b)(3)(F).

¹² See Rule 6.51, Interpretation and Policies .03. See also Amendment No. 1, supra note 4.

The Exchange represents that, in connection with the proposed auto-match feature, it will provide the Commission with the following additional data: (1) the percentage of trades effected through AIM in which the Initiating Participant submitted an Agency Order with an auto-match instruction that included a designated limit price and the percentage that did not include a designated limit price; and (2) the average amount of price improvement provided to AIM Agency Orders when the Initiating Participant submitted an auto-match instruction that included a designated limit price and the average amount that did not include a designated limit price, versus the average amount of price improvement provided to AIM Agency Orders when the Initiating Participant submitted a single price (no auto-match instruction).

At least one week prior to implementation of the proposed rule change, the Exchange will issue a notice to Participants informing them of the implementation of the additional auto-match feature. Participants will have an opportunity to make any necessary modifications to coincide with the implementation date.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.¹³ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b) of the Act,¹⁴ in general, and Section 6(b)(5) of the Act,¹⁵ in particular, which requires that the rules of an exchange be designed, among other things, to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to

¹³ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(5).

remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that the proposal to permit Initiating Participants to stop an Agency Order for fewer than 50 contracts at the better of the NBBO or the order's limit price will continue to provide customers with an opportunity for price improvement over the NBBO. The Commission also believes that the proposal will continue to provide Participants with incentives to compete in AIM Auctions. The Commission notes that once an Agency Order is submitted into the AIM Auction, the submission may not be modified or cancelled. Therefore, the Agency Order submitted to the AIM Auction will be guaranteed an execution price of at least the NBBO and, moreover, will be given an opportunity for execution at a price better than the NBBO.

The Commission notes that the Initiating Participant's maximum allocation in the auction will be only 40% (or 50% in the case of a single price submission where only one other market maker matches the price). Further, C2's current rules provide for broad participation in the AIM Auction,¹⁶ which should allow for a meaningful, competitive auction. Moreover, the Commission believes that the proposal may encourage increased participation in the AIM by Participants willing to trade with an Agency Order of less than 50 contracts at the NBBO but not better than the NBBO. The Commission also notes that the proposal makes the handling of AIM Agency Orders of under 50 contracts consistent with larger AIM Agency Orders. Finally, the Commission notes that it will continue to receive data from the Exchange pursuant to the AIM

¹⁶ See Rule 6.51(b)(1)(D).

pilot program, and that it will have the opportunity to evaluate the data to assess the impact of the proposal.¹⁷

The Commission believes that the proposal to add an option for Initiating Participants to auto-match competing prices from other market participants up to a designated limit price is also consistent with the Act. The Commission believes that the change may encourage increased participation in AIM because it will allow Initiating Participants to trade with an Agency Order at a price better than the NBBO, but only up to a certain price.¹⁸ In addition, the Exchange will provide the Commission with data showing the average amount of price improvement provided to AIM Agency Orders when the Initiating Participant submitted an auto-match instruction versus the average amount of price improvement provided when there is no auto-match instruction. This additional data will allow the Commission to evaluate this change.

Thus, for the reasons set forth above, the Commission believes that the proposal is consistent with the requirements of the Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁹ that the

¹⁷ See Amendment No. 1, supra note 4.

¹⁸ The Commission also notes that the Exchange's auto-match proposal is similar to the current rules of the Boston Options Exchange Group, LLC ("BOX") and the International Securities Exchange, LLC ("ISE") relating to the Price Improvement Period ("PIP") and Price Improvement Mechanism ("PIM"), respectively. See Securities Exchange Act Release Nos. 62644 (August 4, 2010), 75 FR 48395 (August 10, 2010) (SR-ISE-2010-61) (notice of filing and immediate effectiveness of rule change to add auto-match functionality in the PIM) and 61805 (March 31, 2010), 75 FR 17454 (April 6, 2010) (SR-BX-2010-022) (notice of filing and immediate effectiveness of rule change to add auto-match functionality in the PIP).

¹⁹ 15 U.S.C. 78s(b)(2).

proposed rule change (SR-C2-2011-043), as modified by Amendment No. 1 thereto, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Kevin M. O'Neill
Deputy Secretary

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²⁰ 17 CFR 200.30-3(a)(12).